CORPORATE
Newsletter

May 2018 **Issue 44**

Budget Season 2018 — Corporate Tax Changes

IN THIS ISSUE

Federal Budget Highlights

As noted, there are various exceptions where a shareholder loan or debt is not included in income. They are summarized below.

Passive Income

In summer 2018, the federal government announced that it intended to make several changes to the taxation of private corporations. One of these related to tax planning by using a private corporation passive income, but the government did not provide any definitive guidance on what they planned to do. Essentially, small business owners in high tax brackets could potentially realize tax savings by investing their low-tax small business income in their private corporation for long periods of time.

In Budget 2018, the government finally showed its cards regarding what type of tax rules would be introduced to stop this type of tax planning. There are essentially two main changes: reduction to the small business deduction limit and an overhaul of how private corporations pay tax on passive income.

Reduction of Small Business Limit

If specific criteria are met, a private corporation is eligible for a preferential tax rate on up to $500,000 of its small business income. This small business tax rate is much lower than what bigger corporations pay on their income. However, applicable to tax years beginning after 2018, a corporation's small business limit will be reduced where it earns more than $50,000 of passive income in the year. For every $1 of passive income earned, the corporation's small business limit is reduced by $5. Therefore, if a corporation earns $150,000 or more passive income in a year, it's small business limit is reduced to zero and it must pay a higher tax rate on its small business income. The intent of this policy change appears to be to disincentivize private corporations from earning passive income.

If you don't earn passive income in your corporation, or you don't earn passive income that is remotely near $50,000, there is nothing to worry about with regard to this change. However, there is cause for concern where your business holds a lot of passive assets that consistently earn more than $50,000 per year.

Changes to Taxation of Passive Income

The taxation of passive income earned by private corporations is a complicated matter. In the most simple terms, private corporations pay a tax on passive income, but that tax is added to a pool and later refunded when the corporation pays a dividend out to the shareholders. Budget 2018 proposes to add further complexity to this system. There will now be two refundable tax pools to track for the corporation. The basic logic behind this change is that there are two types of dividends a corporation can pay, and one of them carries a lower tax burden when it is taxed in the hands of the shareholder. Potentially, a corporation could pay out the tax-preferential dividends and get back its refundable taxes paid on income that should have been less tax-preferential when paid as a dividend. This would give shareholders of private corporations an unintended tax advantage.

This explanation is a gross oversimplification, but the government intends to stop this practice by introducing two separate refundable investment tax accounts for a private corporation. Each pool can only be refunded if certain types of dividends are paid. This tax change will affect corporations differently depending on what type of active and passive income they earn, so it's important to ask your tax adviser about how these changes will affect your business. This change also applies to tax years beginning after 2018.

At-Risk Rules and Tiered Partnerships

A tiered partnership is essentially a partnership with one or more partners that is also a partnership. The at-risk rules essentially provide that a partner cannot deduct a partnership loss greater than the amount of capital they have invested in the partnership, or the "at-risk amount". A recent court decision established that these at-risk rules do not apply to losses allocated to partners who are another partnership. However, Budget 2018 overrides this court decision by clarifying that these at-risk rules do in fact apply to tiered partnership structures.

Increased Transparency for Trusts

In an effort to increase transparency of beneficial ownership in Canada, Budget 2018 announced that certain trusts will be subject to new information reporting requirements. Currently, trusts can be used in certain structures to hide the identity of beneficial owners of property. If a trust does not earn income, it is not required to file a tax return. Moreover, if it does earn income and file a return, it is not required to disclose all beneficiaries to the government.

Trusts will be required to report the identity of all trustees, beneficiaries and settlors of the trust, as well as the identity of each person who has the ability (through the trust terms or a related agreement) to exert control over trustee decisions regarding the appointment of income or capital of the trust (e.g., a protector). The CRA will also be given more resources to update its systems to allow for this information disclosure, and to enforce the new compliance rules.

Provincial Budget Highlights

Noteworthy corporate tax changes announced in the provincial/territorial Budgets are outlined below. Any provinces/territories not mentioned below either have yet to table a budget, or did not announce any significant corporate tax changes.

Ontario

The corporate tax measures announced in the Ontario Budget primarily relate to intellectual property and research. The Ontario Research and Development Tax Credit will be enhanced by increasing the credit from 3.5% to 5.5% for expenditures (over $1 million in a tax year) incurred on or after March 28, 2018. The Ontario Innovation Tax Credit will be enhanced by increasing the credit from 8% to 12% where the ratio of R&D expenditures to gross revenue is 20% or greater (enhancement is prorated between 10% and 20%). The province is also reviewing potential tax incentives to encourage intellectual property that was developed in Ontario to remain in Ontario once it is commercialized.

Quebec

The $5 million total payroll threshold for computing an employer's health services fund contribution will be gradually increased to $7 million from 2019 to 2022; this means that more businesses will benefit from lower contribution rates. The Budget also states that previously-announced reductions to the contribution rates will be larger than originally promised. Businesses in the primary and manufacturing sectors, and the service and construction sectors will see their employer health services fund contribution rates gradually decrease as well.

The small business tax rate for small and medium businesses (other than primary and manufacturing sectors) will gradually decrease to 4% by 2021.

The 35% additional capital cost allowance will be increased to 60%, applicable to manufacturing and processing equipment and general-purpose electronic data processing equipment acquired before April 1, 2020.

Budget 2018 proposes to introduce a refundable tax credit (up to $5,460 of assistance) for small and medium-sized businesses for training employees.

Quebec Sales Tax and E-Commerce

Currently, suppliers outside of Quebec with no physical or significant presence are not required to register for, collect, or remit QST. The Budget proposes a new QST regime to target online sales of tangible and intangible property and services. Suppliers will be required to register under a simplified QST system and collect and remit QST with respect to online purchases. Non-resident suppliers, including Canadian suppliers outside of Quebec in the case of taxable supplies of tangible property, will be subject to the new rules. The new regime will also apply to digital property and services distribution platforms that act are intermediaries that control key elements of transactions. The tax will only apply where the buyer is a specified Quebec consumer.

Suppliers will need to register and begin collecting QST by January 1, 2019, but Canadian suppliers otherwise have until September 1, 2019 to be compliant.

Newfoundland and Labrador

The exemption threshold for payroll tax will be increased from $1.2 million to $1.3 million, effective January 1, 2019.

Manitoba

The small business deduction limit will increase from $450,000 to $500,000, effective January 1, 2019. Also, the minimum investment for the small business venture capital tax credit is lowered from $20,000 to $10,000, effective March 12, 2018.

The small business venture capital tax credit will be amended, effective March 12, 2018, by lowering the minimum investment from $20,000 to $10,000 and by eliminating the $15 million revenue cap for eligible corporations.

Effective September 1, 2018, Manitoba will impose a carbon tax at a rate of $25 per tonne of greenhouse gas emissions. It will apply to all gas, liquid, and solid fuel products. The carbon tax on transportation fuels will be collected and remitted through the existing fuel tax system. The carbon tax on natural gas will be collected by Manitoba Hydro. Carbon levies on other carbon-intensive fuels will be required to be collected and remitted by the purchaser.

British Columbia

An employer health tax will be implemented, effective January 1, 2019. The tax will be applied at a rate of 1.95% of an employer's total payroll (this rate is less where payroll is less than $1.5 million). As a result, Medical Services Plan premiums are eliminated as of January 1, 2020.

Nova Scotia

Although few details are currently available, the government intends to introduce a new Innovation Equity Tax Credit, beginning January 1, 2019. The current equity tax credit will be phased out over time.

Prince Edward Island

The small business corporate income tax rate will be reduced from 4.5% to 4% in this fiscal year. Budget 2018 noted that this is the first decrease of a multi-year commitment to strengthen PEI's competitive advantage, but did not provide details of any planned future changes.

Saskatchewan

Budget 2018 announced a new Saskatchewan Value-Added Agriculture Incentive for value-added agriculture facilities that make a minimum capital investment of $10 million in new or expanded productive capacity. It provides a non-refundable corporate income tax credit equal to 15% of qualifying capital investments. Redemption of the benefits is limited to 20% in the first year after the facility enters operation, 30% in the second year, and 50% in the third year.

Budget 2018 also announced a new Saskatchewan Technology Start-up Incentive, which will offer a 45% non-refundable tax credit for individual and corporate equity investments in eligible technology start-up businesses. It will be capped at a maximum annual benefit of $140,000 per investor. Eligible small businesses are early stage technology start-ups that are developing new technologies or applying existing technologies in a new way to create new proprietary products, services, or processes that are repeatable and scalable. Eligible small businesses must also be incorporated and headquartered in Saskatchewan and have fewer than 50 employees, the majority of which are located in the province